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¶1. (U) Summary. Syria,s economy is benefiting from the high price of oil and other positive trends, but faces two chronic economic problems that could become acute in the next two to three years: decreasing oil production and rising unemployment. The economy is also hamstrung by a number of short-term vulnerabilities that have the potential to trigger economic instability. End summary.

¶2. (SBU) As one of its strategies for reassuring the Syrian public during its current confrontation with the international community, the SARG has tried to create a sense of economic progress in the country (ref A). The two main refrains of the SARG,s economic cheerleading have been its claim that both foreign direct investment (FDI) and the GDP growth rate are increasing significantly. In late 2005, Prime Minister Otri announced that the year,s GDP growth rate would reach 4.5 percent, more than doubling the previous year,s official rate. Otri,s prediction has subsequently become the official SARG GDP growth rate for 2005 even though Syria,s Central Bureau of Statistics has yet to produce the basic macro-economic numbers to support the assertion. Independent economists and Syrian businessmen view both SARG claims as mostly hype, pointing to the lack of construction on any of the Gulf investment projects (ref B), and to Syrians' widely held belief that both their purchasing power and standard of living continue to erode.

Positives

¶3. (U) Despite the SARG,s obvious exaggeration of FDI and GDP growth, Syria does have some economic strengths. In the last few years, the SARG has succeeded in restructuring its foreign debt to a relatively low level, approximately 13 percent of GDP. During the same time period, the SARG has accumulated significant hard currency reserves that its

officials claim approach USD 18 billion, enough for two and a half years of imports, if true. As an oil exporting country, Syria,s economy is benefiting from the sustained high price of oil. The second main pillar of the country,s economy, agriculture, benefited from better than average rainfall in 2005, though 2006 totals may be modestly lower. Ironically, its tourism sector benefited from the downturn in Gulf tourism to Lebanon last year (ref D), and the country also profits from being the shortest trans-shipment route for Iraq reconstruction goods coming from Europe or the US. Also, Gulf investors are undoubtedly sympathetic to the SARG and willing to echo its upbeat self-assessment of Syria as a good place to invest (ref C). Finally, the SARG has succeeded in, at least temporarily, stabilizing its currency after the Syrian Pound (SYP) devalued dramatically last fall (ref E).

Medium Term-Challenges

¶4. (U) There is another side of the coin, however, that is more ominous. In the medium-term, the SARG faces two significant economic challenges: crossing over from being a net oil exporting country to being a net oil importer, and a population growth rate that continues to outpace its GDP growth rate. Each year an additional 200,000-plus young people enter the job market. The official unemployment rate is currently 12 percent, though most informed observers have been putting it at over 20 percent for years. The SARG has recently acknowledged the public sector,s inability to absorb any significant number of new entrants, though it continues to ignore the pressing need to restructure and downsize the public sector. The SARG,s much-touted 10th Five Year Plan (ref J), has put the onus on the private sector and FDI to create the vast majority of the new jobs

needed to reverse the trend of growing unemployment. Syria,s businessmen, however, continue to prefer to invest abroad and FDI has generated less than 200,000 jobs total since 1991, when the SARG enacted its first investment law designed to attract FDI.

¶5. (SBU) Added to the burgeoning unemployment, Syria,s oil production is decreasing annually at a rate of approximately 15 percent. According to the SARG,s own statistics, the oil sector still accounts for 20 percent of GDP, 70 percent of exports, and 40 percent of government revenues. At the same time, consumption rates for oil derivatives are booming: gasoline consumption increased by 13 percent last year, while diesel consumption increased by approximately ten percent. Conventional wisdom holds that within two to three years Syria will cross over from being a net exporter of oil to being a net importer, but if last year's consumption trend continues, the crossover could happen even sooner. Local economists subsequently view managing the crossover as the country,s largest economic challenge. When added to the fact that each year Syria witnesses a significant increase in the number of unemployed young people, local economists worry that the country faces potential economic instability in the medium-term, if current trends are not reversed.

Short-Term Vulnerabilities

¶6. (SBU) In addition to its medium-term economic problems, the SARG has three major short-term liabilities: rising prices, the potential return of a highly volatile exchange rate, and increasingly unsustainable expenditures for subsidies. Subsidies are expected to cost the SARG an estimated USD 5.5 billion in unbudgeted expenditures this year (ref F). Added to the SARG,s official 2006 budget deficit of USD 1.2 billion, this year's deficit could approach as high as 30 percent of GDP, if the SARG does not lower subsidies. (Note. The SARG,s revenues are also not fully accounted for in the budget, which further complicates accurately projecting the potential size of the SARG deficit. End note.) Though the SARG has a plan for gradually lifting subsidies, the regime has recently backed away from

implementing scheduled price increases of basic commodities out of fear of potential social unrest (ref G), and concern over feeding the SARG,s second economic liability) rising prices.

¶7. (U) Importers and local manufacturers started raising prices last fall when the Syrian Pound (SYP) devalued by over ten percent. For the last three months, the increase in prices of basic commodities and the adverse impact they are having on the average Syrian has become a persistent news story in the state-controlled press. In addition to delaying the lifting of subsidies, the SARG has responded to rising prices by blaming unscrupulous businessmen for the increase and has redoubled its efforts to enforce price controls (ref H). The fact that prices have continued to rise even after the SARG successfully intervened to reverse the precipitous fall in the SYP,s value highlights the link between rising inflation and the SARG,s third economic problem) an unsustainably high exchange rate.

¶8. (SBU) The SARG continues to spend an unspecified portion of its hard currency reserves in the black market to drive down the exchange rate for the US dollar. Before the SARG began its intervention on December 8, 2005, the SYP had devalued from 53.10SP to over 60SP per USD (ref E). As of today, the official rate is 51.95 while the black market rate is 52.20 per USD and both rates are continuing downward. Local economists often choose 55SP per USD as a potentially sustainable rate of exchange for the SYP and are at a loss to explain, from an economic perspective, why the SARG continues to intervene to artificially overvalue its currency. They point to the apparent contradiction of the SARG,s stated priority of encouraging exports to diversify its export base from oil with its ongoing drive to overvalue its currency, which makes its exports more expensive and less competitive. Most Syrians explain the SARG,s action as an attempt to teach a lesson to those who bought dollars last fall when the SYP was seemingly in free-fall, and to discourage them from

doing so again should the SYP show similar volatility.

Predicting the Future

¶9. (SBU) Complicating the SARG,s ability to successfully maintain its intervention is the fact that a huge portion of Syria,s economy remains in the informal sector (ref I). Both the SYP,s devaluation and its continuing revaluation have been driven by the black market. The UNDP estimates that 35 percent of the country,s work force is in the informal sector. All Syrian businesses keep multiple sets of books, which ensures the government has no accurate assessment of current business activity in the country. Smuggling is rife, so the SARG's trade numbers are equally off base. The expatriate work force is huge and repatriates its earnings primarily through the informal sector. All of this means that even if the SARG,s economic numbers were not slow and manufactured, they would still risk being seriously inaccurate.

¶10. (SBU) Comment. The SARG is not sufficiently competent to actively manage its economy, but still shows prowess at stifling new business activity through its inefficient public sector and its promotion of corruption. The high price of oil and current lack of international pressure, however, have lightened the consequences of its economic mismanagement and malfeasance on the Syrian public. Still, the SARG is taking no serious action to avoid the economic shoals ahead, which only increases its economy's vulnerability to a drop in the price of oil or renewed international pressure. With its economic liabilities continuing to grow, it seems to be only a matter of time before its current fragile stability is threatened.
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